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C O N F I D E N T I A L QUITO 002491

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TREASURY FOR MEWENS
DEPT FOR WHA/EPSC FAITH CORNEILLE

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TAGS: [EPET](#) [EINV](#) [ENRG](#) [ECON](#) [PREL](#) [EC](#)
SUBJECT: PETROECUADOR RECOMMENDS CANCELLING U.S. CITY
ORIENTE,S PETROLEUM CONTRACT

REF: A. QUITO 2373

[1B.](#) 06 QUITO 1722
[1C.](#) QUITO 2277

Classified By: Classified by: DCM Jefferson Brown, Reasons 1.4 (b&d)

[11.](#) (C) Summary: Petroecuador recommended on November 8 that the GOE cancel U.S. oil company City Oriente,s contract, since the company has not made any payments to the GOE under a 2006 law requiring companies to provide the government with at least 50% of "extraordinary" petroleum revenues. A final decision on whether to cancel the contract will be made by the Petroleum Minister Chiriboga, who was surprised by the Petroecuador recommendation. On November 5, Chiriboga told the Ambassador that the GOE was not planning to seek contract cancellation at this time. End Summary.

[12.](#) (SBU) The GOE has been investigating foreign oil companies (reftel A) that have not fully paid all the money they owe under Ecuador,s &50/50 law8 of 2006. The law requires that companies share at least 50 percent of extraordinary revenues with the State (reftel B). On November 1, state oil company Petroecuador issued a statement claiming that it would initiate "coactiva" (embargoing or seizing a company,s barrels of oil as they go through the pipeline) or "caducity" (canceling a company,s contract and seizing its assets) in payment for debts owed under the law. It also issued a report detailing which companies have allegedly not complied with the law (basically five major foreign oil operators in Ecuador) Chinese Andes Petroleum, Brazilian Petrobras, Spanish Repsol, French Perenco, and American City Oriente (the smallest). City is the only company to have refrained from making even partial payments. Petroecuador estimates the unpaid debt owed by all companies totals \$236 million.

Ambassador Speaks with Energy Minister

[13.](#) (C) On November 5, the Ambassador spoke with Petroleum Minister Galo Chiriboga about City Oriente,s situation, after City Oriente had heard that Petroecuador,s legal office would recommend caducity. She made the point that since City Oriente is negotiating with the GOE to revise its contract, a recommendation of caducity could be very difficult to stop and could preclude a negotiated agreement. She suggested delaying a formal recommendation for caducity so the two sides would have more room to pursue a negotiated settlement. After a brief interval, when he presumably

checked with Petroecuador, Chiriboga called the Ambassador back to state that the report was not true and that the GOE was not going to pursue caducity at this time.

Petroecuador Recommends & Caducity8 Regardless

¶4. (SBU) On November 8, Petroecuador Executive President Carlos Pareja sent forward to Minister Chiriboga a formal recommendation of caducity for City Oriente, recommending the company's contract be cancelled because it has not paid any money owed under the extraordinary revenue law. (Note: the Petroecuador recommendation is not a final decision. A formal decision on whether to cancel City Oriente's contract will be made by Minister Chiriboga.)

¶5. (C) Petroecuador is also looking at the other foreign oil companies who have not paid what they have been billed under the 50/50 law (City Oriente reportedly owes \$28 million; some companies owe even more). The state company is considering "coactiva" for the other companies. Of the five major foreign operators, Repsol and Perenco are currently possible candidates for coactiva. Petroecuador has noted that Andes Petroleum and Petrobras already have price indices in their current contracts (when prices increase, they share more petroleum revenue with the state), so may already be paying at least a share of what is required under the law. Petroecuador will conduct further analysis of these two contracts.

Background:

¶6. (C) While most oil companies have failed to pay all of the money billed by Petroecuador under last year's law, City Oriente is the only firm that has paid nothing. (Because it

is a small operation and highly leveraged, City Oriente claims it is simply not able to make any other financial arrangements.) City Oriente considers the law a unilateral change to the terms of its contract, and has sought international arbitration to resolve the issue. It has put some of the money owed into an offshore account pending the conclusion of its international arbitration case but has not paid any to the GOE.

¶7. (C) On October 31, the ICSID tribunal for the case participated in a conference call with City Oriente and GOE representatives. The tribunal asked that the GOE not take any actions against City Oriente that would change the status quo, including embargoing City Oriente's oil or nullifying its contract. It further reinforced this with a letter ordering the GOE not to make said changes until it had the opportunity to consider City Oriente's request for provisional measures. The arbitration panel heard City Oriente's arguments for provisional measures on November 9. The GOE, which does not yet have a legal team for this case, did not participate in the hearing.

¶8. (U) In response to press questions November 9, Ambassador Jewell refrained from comment on the specific merits of the case but noted that the Embassy supports City Oriente's right to arbitration as an impartial, legal and appropriate recourse to address the company's contract dispute. On November 13, the Ambassador reiterated this position when the matter came up during a meeting with the acting Foreign Minister.

Comment:

¶9. (C) All of the foreign oil companies are struggling to cope with the GOE's changing rules of the game, and we do not believe that City Oriente was targeted solely because it is a U.S. company. City Oriente has been more vulnerable than other companies to GOE retaliation for underpayment under the 50/50 law since it decided not to pay anything. Unlike some of the other players, it is also marginal in terms of

production and, as a fully private company, does not benefit from strategic considerations that may mitigate in favor of some of the other state-owned companies. The firm,s General Manager Kyle Ford expressed his appreciation for the Ambassador,s call to Minister Chiriboga, but even at the time City Oriente appeared to be resigned to an eventual caducity declaration and is now focusing its efforts on the arbitration process. Minister Chiriboga appeared to be blindsided by the caducity recommendation, the second time in a month that he did not appear to be in the loop on a key decision affecting the petroleum sector (it also appeared that he was not consulted before President Correa issued the 99 percent revenue sharing decree on October 4) reftel C.) We will continue to consult with City Oriente on possible next steps, but based on the experience of Occidental Petroleum, whose contract was cancelled in 2006, it will be difficult to reverse the caducity process now that a formal recommendation has been made.

JEWELL